In the

United States Court of Appeals

For the Ninth Circuit

No. 14695

MID-STATES INSURANCE COMPANY, a corporation, and THE ANGLO CALIFORNIA NATIONAL BANK OF SAN FRANCISCO, *Appellants,* *vs.* AMERICAN FIDELITY AND CASUALTY COMPANY, INC., a corporation, THE AMERICAN PLAN CORPORATION, a corporation, MARK HART, JOSEPH LOTZ and RALPH L. SMEAD, *Appellees.*	Appeal from the United States District Court for the Northern District of California, Southern Division.

REPLY BRIEF FOR APPELLANT, MID-STATES INSURANCE COMPANY.

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Authority Cited.

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INTRODUCTION.

Since much of the argument presented by appellees, American Fidelity and American Plan, in their brief are fully covered in the initial brief filed on behalf of Mid-States, this reply brief will be limited to a consideration and discussion of only those points which we believe are essential to this court's consideration of the essential facts

and the theory relied upon by American Fidelity and American Plan in support of the judgment of the trial court.

At the outset, we desire to emphasize that Mid-States does not contend that this case is triable *de novo* in this court, as was apparently the theory of the appellant in *Ruud* v. *American Packing etc. Co.,* 177 F. 2d 538 (1949), cited in the brief for American Fidelity and American Plan. We contend, rather, that such evidentiary weight and such convictional certainty are present from the *undisputed evidence* in this case that it must be concluded that the trial court failed to make a sound survey of or to accord the proper effect to all the cogent facts, even after giving due regard to its appraisal of witness credibility where that factor is involved.

As we pointed out in our original brief, a number of findings of the trial court relied upon as errors are determinations of mixed questions of law and fact, and we contend that these findings, together with the court's conclusions of law and the judgment entered by it, resulted from erroneous inferences or conclusions drawn from undisputed facts or from an erroneous view of the law. That this court may review such findings is well established by the authorities cited in our original brief. However, in view of its particular application to the record in this case, we refer here to *American Tobacco Co.* v. *The Katingo Hadjipatera,* 194 F. 2d 449 (1951), where the Court of Appeals reversed the finding of the trial court that the stowage of certain additional bales of tobacco in No. 3 tweendeck of the defendant ship so impeded ventilation of the No. 3 hold as to cause the fire damage which resulted to cargo stowed there. The court stated, at page 451:

> "We are not required, however, to accept a trial judge's findings, based not on facts to which a witness testified orally, but only on secondary or derivative infer-

ences from the facts which the trial judge directly inferred from such testimony. We may disregard such a finding of facts thus derivatively inferred, if other rational derivative inferences are open. And we must disregard such a finding when the derivative inference either is not rational or has but a flimsy foundation in the testimony.''

Since Mid-States has no interest in the third party claim of The Anglo California National Bank of San Francisco against the defendants, this brief will make no reference thereto or to the latter's brief.

ARGUMENT.

The brief of American Fidelity and American Plan is devoted largely to isolating specific acts or testimony of each of the defendants and ignoring the undisputed facts evidencing the entire course of conduct starting in August, 1951, which gave rise both to Mid-States' loss and its right of recovery. It is true that one can pinpoint certain facts which, if taken alone and not in relation to other acts, might be consistent with permissible conduct rather than either a conspiracy to defraud or concerted action in breach of Lotz' fiduciary relationship to Mid-States. What Mid-States has proven in this case, however, is a course of conduct constituting either or both such actionable wrongs.

There is no question that Smead lied at various times regarding the contents of the statements signed by him in December, 1951, and that the trial court stated that it could give little credence to his testimony. It should be noted that Mid-States, unlike the defendants, never embraced Smead. He was a party defendant and Mid-States called him as an adverse witness. Its position regarding his statements has always been consistent—in both the instant case and Mid-States' suit against the Anglo Bank, Mid-States' position was that the statements were true. *Mid-States, however, does not rely on Smead's statements or his testimony.* There is no dispute in the record that Lotz signed the first statement and that Smead's signature thereon was acknowledged by Lotz' attorney, Mead (R. 928-930). Lotz never denied the truth of this statement. Lotz also wrote out and signed a separate statement, and by his own admissions in the record corroborated many of the facts contained in that and subsequent statements. It

is particularly significant that Mead, although he was Lotz' attorney and was representing Smead as Lotz' employee until after all the statements in the record had been given, was thoroughly familiar with Lotz' affairs, knew the statements had been given and at no time denied their truth (Mid-States Br. 45). American Fidelity and American Plan devote considerable space in their brief to emphasizing the manner in which the December 6 statements of Smead and Lotz were taken. They say the evidence shows that the statements were not read in Mead's office and were not taken in his presence as he had been promised. The only important question, however, is the truth of the statements. Mead, notwithstanding his testimony that the statement of December 6 was not taken in his office, acknowledged the signature of his client allegedly without reading the statement, and thereafter continued to represent his client in connection with all of the matters relating to the latter's agency operations. He testified that notwithstanding such representation he never read any of the statements, although he knew, of course, they had been given.

American Fidelity and American Plan further comment at length on the alleged physical condition of Lotz and his self-serving testimony that he was influenced by Smead's point of view and was in a "bad nervous condition" and unable to remember certain details regarding the facts set forth in the statements. Yet these defendants fail to mention or even recognize the undisputed evidence of Lotz' thorough familiarity with the conditions and workings of his Agency, his maintenance of the black book in which he currently recorded the payments being made to American Fidelity on its account, his preparation of a supplemental statement on December 7, 1951, without the aid of anyone else, his knowledge of the additional statement written by Smead on December 7, 1951, his presence when Plaintiff's

Exhibit 22 was prepared and the final corrections made therein, and the many other undisputed facts reviewed in detail in Mid-States' original brief (Mid-States Br. 28-30). It is significant, also, that American Fidelity and American Plan do not deny Lotz' legal responsibility for his own acts as well as for those of his agent Smead. That such liability exists, regardless of the physical condition of Lotz or his negligence or inattention to business, has been amply demonstrated in Mid-States' original brief. The trial court completely disregarded this rule of law. American Fidelity and American Plan would have this court conclude that Lotz' physical condition and purported nervous state (about which there is no evidence other than his own self-serving testimony) were considered by the trial court as bearing upon the responsibility of Mid-States for the loss it incurred "since it was aware of Lotz' condition". None of the facts relating to Lotz' condition from August to December, 1951, were known to Mid-States until the end of November or early part of December, when all of the facts relating to the course of conduct of the defendants were first disclosed to Mid-States.

American Fidelity and American Plan stress the early history of Lotz' activities prior to his becoming general agent for Mid-States, the delinquencies in his account from time to time with Mid-States and his use of premium funds to pay operating expenses and subagents' commissions, and they argue that these facts support the trial court's findings and conclusion that no fiduciary relationship existed between Lotz and Mid-States. At one point (A. F. and A. P.'s Br. 2-3) they argue that Lotz' method of keeping his books was inconsistent with trust; at another point (A. F. and A. P.'s Br. 21) they argue that his tardiness in payments to Mid-States was also inconsistent with trust; but at another point (A. F. and A. P.'s Br. 24) they say these were not the practices which destroyed the trust

character of the agency funds. Of greater significance, however, is the fact that they completely ignore, as did the trial court, the history of Lotz' relations with Mid-States prior to August, 1951, American Fidelity's own investigation of the Lotz agency prior to its appointment of Lotz as its general agent, and the complete lack of any evidence in the record of any wrongful conduct on Lotz' part during those years (Mid-States Br. 21-23). It is submitted that the uncontroverted facts conclusively show that a fiduciary relationship existed between Lotz and Mid-States at all times prior and subsequent to August, 1951, and that there is no evidence in the record to substantiate the trial court's finding to the contrary. This phase of the case and the applicable authorities are fully set forth in Mid-States' original brief.

American Fidelity and American Plan devote a considerable portion of their brief to a discussion of whether or not the premiums collected by Lotz on insurance written for Mid-States constituted trust funds under the applicable law and Lotz' contract of September 1, 1951 with Mid-States, and argue that if they were not trust funds, Mid-States can have no cause of action against the defendants. We do not deem it necessary to extend this brief by further discussion of that question, since both the facts and the law have been amply covered in Mid-States' original brief. We submit that the dealings between Lotz and Mid-States prior to September 1, 1951 have no bearing on the question of whether premiums collected thereafter constituted trust funds. We emphasize, however, that assuming, *arguendo,* that premiums did not constitute trust funds, that fact in no way affected or destroyed the fiduciary character in all other respects of the relationship of Lotz as general agent for Mid-States, or the duties of full disclosure and fair dealing flowing from that relationship. Mid-States' right of recovery is not dependent upon

a finding that premium collections constituted trust funds or upon the necessity of tracing specific premium collections through Lotz' accounts. Hart admitted that his company had no right to participate in the Public Services moneys (R. 877). Evidence of the use of premium funds paid in connection with the Public Service Rewrite was offered as further proof of Lotz' breach of his fiduciary duties to Mid-States and the participation therein of American Fidelity and American Plan, who had full knowledge of the source of the payments. We emphasize this point, notwithstanding a full discussion thereof in Mid-States' original brief, in view of the space devoted in the brief of American Fidelity and American Plan to the nature of premium funds and the problem of tracing. We are also prompted to ask at this point what the American Fidelity Rewrite, which involved no handling or exchange of funds at all, has to do with premium collections or trust funds?

American Fidelity and American Plan argue that "the loss ratio involved no wrong". They state that Lotz' loss ratio on business written for Mid-States after September 1, 1951 was 68.51%, that this was only 3.86% higher than that of the previous year, and that it was much better than the loss ratio on the business written by Lotz for American Fidelity, which was 79.51%. They argue further that accordingly the losses did not invade the 14% of the premium retained by Mid-States and that it got a better class of business than Lotz wrote for American Fidelity. These are not correct statements of the evidence. American Fidelity's own auditor, Mr. Marks, testified that he had made no breakdown of the loss ratio attributable to the policies taken over in the Public Service Rewrite. And the evidence is undisputed that the loss ratios on the business written by Lotz for Mid-States (which included the Public Service and American Fidelity Rewrites) for the

four months subsequent to August, 1951, averaged 92.6% (R. 412). The figure of 68.51% given by American Fidelity and American Plan covers the loss ratio from September 1, 1951 "and onward" (R. 979) and includes the year 1952. The great bulk of the policies written by Lotz after September 1, 1951 in Mid-States (including the Public Service and American Fidelity Rewrites) was cancelled by Mid-States in the latter part of December, 1951 and in January, 1952. The loss ratio for 1952 was only 36% (R. 413). Thus, the figure of 68.51% stated in the brief of American Fidelity and American Plan is wholly inaccurate and reflects the reduced loss ratio in 1952 after the cancellation of the business written by Lotz in Mid-States between September and December, 1951, the loss ratios on which before cancellation were in excess of 100% for three of the four months, and average 92.6%.

Although there is no dispute in the record as to Lotz' insolvency throughout the period from August 1, 1951, to the termination of his Agency by Mid-States, American Fidelity and American Plan argue that the defendants did not know until December, 1951, that Lotz was insolvent or unable to meet his obligations. They comment on the prospects of a loan which Lotz was seeking from the Central Bank of Oakland, the more favorable deal he received from Mid-States in September, 1951, under which he was to receive a 15% prepaid commission, and a purported $60,000 equity of Lotz in a $300,000 unearned premium reserve with American Fidelity. They argue that Mr. Hart was under no great concern with respect to liquidating his balance and that Mr. Feller and Lotz felt the same way. However, the undisputed facts are that the receivables on American Fidelity business in August, 1951, were substantially less than the premiums owing by Lotz to American Fidelity on that business, that the loan was never

obtained, and that after American Fidelity's indebtedness had been paid Lotz' purported equity in the unearned premium reserve had disappeared. It is submitted that the trial court's finding that the defendants did not know prior to December 1, 1951, that Lotz was insolvent or that he would be unable to meet his obligations to Mid-States is completely contrary to the undisputed evidence in the case. American Fidelity and American Plan knew that Lotz could not pay them the amounts owing to them by September 15, 1951 (the date specified in the agreement terminating Lotz' agency with American Fidelity), that he was unable to procure the loan which had been discussed with the Central Bank of Oakland, and that the only way American Fidelity could possibly obtain payment from Lotz was to place its own representative in Lotz' office to corral all funds coming into the office, and when even that failed, to arrange through misrepresentations to cancel a part of its liability through the device of shifting to Mid-States policies previously written by Lotz for American Fidelity. All of these undisputed facts are discussed in Mid-States' brief and, it is submitted, do not require further repetition here. It is enough to point out that Mr. Hart knew Lotz did not have the money to pay him; that he knew the Public Service checks had been made payable to Mid-States and that American Fidelity was being paid with Public Service moneys; and that at the end of October, 1951, when Lotz' indebtedness to American Fidelity had been reduced from approximately $247,000 to approximately $61,000, the only way the balance could be paid or taken care of was through the American Fidelity Rewrite which was consummated after the telephone conversation between Mr. Hart and Mr. Hatfield, in which Mr. Hart made the misrepresentations which induced Mid-States to consummate the transaction. It is difficult to imagine a situation in which greater knowledge

of one's insolvency could be available, unless it is assumed, as the trial court obviously did, that in order to establish knowledge of another's insolvency, it is essential to prove knowledge of the exact amount by which his liabilities exceed his assets. It is submitted that such is not the law, that inability of a debtor to meet his debts as they mature constitutes insolvency, and that knowledge by another of that fact is knowledge of the debtor's insolvency. And in any event, it is clear in the instant case that American Fidelity and American Plan had full knowledge of Lotz' financial condition through the knowledge of their agent, Smead.

The arguments tendered by American Fidelity and American Plan in support of the findings and conclusions of the Court with respect to the American Fidelity Rewrite are unworthy of serious consideration by this Court. There is no dispute in the record as to the exact statements made by Hart during the telephone conversation or that these statements were untrue. We have reviewed these statements and the law applicable thereto in our initial brief. However, we again point out that the misrepresentations made by Hart were not misunderstood or ambiguous terms. They were definite, specific statements of facts known to Hart. The telephone conversation was carefully planned and secret preparations had been made by Hart for its recording prior to placing the telephone call. Hart emphasized and insisted upon a telegram of acceptance specifying that Mid-States would look solely to Lotz for the premiums. Hart's reply as to when the business had been written and his statement that the premiums were not due "under our contract—we have 75 days * * * actually, until December 15" although he knew full well that the contract had been terminated and that payment from Lotz by September 15, 1951, had been in-

sisted upon, his statement that "we didn't kick them out," and his reference to the 15% advance commission that Lotz had hoped to receive thereon when he already knew that the same had been refused by Mid-States, all clearly show that Hart by deliberate misstatements, half-truths and concealments led Mid-States to believe that Lotz' contract had not been terminated, that Lotz was current in his obligations to American Fidelity and that Lotz, and not American Fidelity, had initiated and desired the Rewrite. As pointed out in our original brief, the law presumes under these circumstances that Mid-States did rely on Hart's misrepresentations unless there is affirmative proof to the contrary and no such proof was or could be offered.

Whether or not Hart intended to deceive Mid-States is not only an inference or conclusion drawn from the undisputed facts by the trial court which is not binding on this Court, which may make its own determination, but is also entirely immaterial. We submit that the record is completely barren of any evidence upon which the trial court could properly make the finding that Hart's words were not fraudulently intended. In fact, as we have shown by the authorities, which are uniform in their assertion of the principles applicable to this situation, the trial court's finding that Hart did not intend to deceive or defraud is erroneous as a matter of law and is not even a permissible inference to be drawn from the facts. Contrary to the statement of American Fidelity and American Plan, the trial court's findings on this subject are completely unsupported by the record.

American Fidelity and American Plan further argue that the liquidation agreement with Lotz (Plaintiff's Exhibit 17; R. 456-460) did not give Smead full control over the agency and its finances except only insofar as they related to American Fidelity and the payment of Lotz' in-

debtedness to it. It is significant, however, that they make no denial or even any reference to the fact that by that agreement Smead, the General Manager of Lotz' agency, became the agent of American Fidelity and American Plan. At the trial, Hart admitted that Smead was their agent (R. 909). As such agent, Smead's knowledge of all of the affairs of the agency, including Lotz' insolvency, became the knowledge of American Fidelity and American Plan, and they in turn became responsible for the acts of their agent (Mid-States' Br. 47, 51-52).

American Fidelity and American Plan urge this Court to accept the rationale of the trial court in its attempt to distinguish the *Machado* case from the instant case. As pointed out in our original brief (Mid-States' Br. 54-55), the court in that case held all the defendants liable for the indebtedness owing by the debtor corporation to the plaintiff creditor *even though no fiduciary relationship existed between the parties.* In its opinion in the instant case the trial court stated that it was its view that the defendants were not aware that Lotz' creditors could not be paid and that no motive, such as close relationship to American Fidelity or dislike of Mid-States, was shown for Lotz to engage in a fraudulent plan. We submit that these conclusions are without foundation in the record. There was obviously even greater intimacy among Hart, Smead (the agent of American Fidelity and American Plan and the General Manager for Lotz) and Lotz in the instant case than between the parties in the *Machado* case, and Lotz' motive in the instant case was far greater, namely, to gain time at the expense of Mid-States in an effort to continue in business. And it would be difficult to assume any state of facts under which American Fidelity and American Plan and their agent Smead could have had greater knowledge that Mid-States could not be paid after August 22, 1951. But American Fidelity and American

Plan argue that the fraud in the *Machado* case was further evidenced by the defendant's giving the plaintiff's daughter a post-dated check without her realizing it. This, we submit, is a completely captious argument. The post-dating was obvious from the face of the check and this was, if anything, a fact favorable to the defendants in that case since the check was returned for non-payment when deposited before the post-date, and the plaintiff could have made inquiry either upon receipt or return of the check instead of merely waiting as it did until the post-date to redeposit the check. The conduct of American Fidelity and American Plan, in concert with the remaining defendants, in the instant case, goes far beyond the conduct of the recipient creditor and the other parties in the *Machado* case.

American Fidelity and American Plan state in the conclusion to their brief that Mid-States' theory of damages is radically mistaken, that even if it were entitled to recover the damages recoverable could not be more than $65,000. No reasons are given for this conclusion and since, as we have shown, there is no dispute in the record as to the amount of Mid-States' damages, we do not deem that question an issue in this Court. In addition, we respectfully refer this Court to the authorities cited in Mid-States' original brief which uniformly hold that all who participate with an agent in a breach of his fiduciary duties or who receive the benefits thereof with knowledge that his actions are in breach of his said duties, are equally liable with him, regardless of the extent of such participation or the benefits received (Mid-States' Br. 62-64).

In passing, we advert to the statement on page 43 of the brief of American Fidelity and American Plan that the trial court did not give Mid-States judgment against Lotz for the undisputed amount owing by him to it because Mid-States sued him for fraud and not contract.

Apparently even American Fidelity and American Plan do not take this contention seriously since they make no attempt to support the statement by either argument or authorities. Mid-States has discussed the applicable authorities in its brief at pages 65-68. The record also shows that the trial court refused to enter judgment against Lotz even after timely motion by Mid-States to amend the judgment, filed pursuant to Rule 59 of the Federal Rules of Civil Procedure. Not only will this action of the trial court, if allowed to stand, result in a gross miscarriage of justice and prohibit any recovery in the future against Lotz notwithstanding his admitted indebtedness to Mid-States, but even more significant, it reflects the trial court's obvious misconception of the entire litigation which led to the erroneous judgment in favor of all the defendants.

It is again respectfully submitted that the Findings of Fact and Conclusions of Law of the trial court specified in the errors relied upon by Mid-States are clearly erroneous, that the undisputed evidence in this case establishes as a matter of law that Mid-States is entitled to judgment in its favor against all the defendants, and that this Court should reverse the judgment of the trial court and remand this cause with directions to enter judgment for $281,746.96 in favor of Mid-States against all the defendants.

Respectfully submitted,

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